PAYING FOR CANADA:
Perspectives on Public Finance and National Programs

A Joint Statement by:

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Reforming the Welfare State: Altering the Course of Canadian Development

Canadians are being told that the welfare state is in ruins and that social programs no longer work, as evidenced by the fact that "child poverty is growing, unemployment rates are near record highs and our national debt soars higher every day". (Toronto Star, September 17, 1994)

We are constantly presented with the proposition that Canada is 'over-spending' on social programs which are no longer 'affordable' and that the budget deficit is, and **must be**, the nation's priority. The logical conclusion is that "a key to eliminating the deficit is the comprehensive structural reform of Canada's social safety net". (Finance Minister Paul Martin quoted in the Toronto Star, April 26, 1994)

Indeed, it is now widely and publicly acknowledged that a major – if not the major – purpose of the federal social security reform is to cut government expenditures in order to help reduce the deficit. This transforms the social security "debate" into a fight about which programs to cut and how to re-distribute reduced benefits among vulnerable groups.

This is an empty debate as long as it is based on false assumptions about the source of the fiscal crisis and as long as there is no discussion of the range of options that are, in fact, available to the federal government.

Let us put this exercise in context.

First, the future of Canadian nationhood is not only predicated on the question of Quebec's separation. The destruction of the social welfare state in Canada poses an equally serious threat to the future meaning and concrete expression of the Canadian nation.

Second, the economic intimidation currently taking place by the Federal Finance Department is being used as an excuse to reduce the levels of public provision and public presence in the economy. The argument goes: Only by balancing the budget can a nation regain its ability to exercise its sovereign will. This is eroding the role of the federal government in sustaining nationhood.

Third, the current drive to reform UI and welfare is being triggered by peripheral concerns: the 3% rate of known abuse on welfare, and the 6% of the population drawing UI that lives in Newfoundland. The government and the media have promoted the view that the vast majority of those who legitimately use these programs are virtually abusing them. This focusses social security reform on issues of dependence and fraud, not despair and poverty.

The real fight in this country is about public responsibility, the public role around shaping economic development. It is a fight about what kind of social security programs we want, about what kind of economy we want and what kind of public finances would bring this about. In essence, this dialogue is about defining the role of government and its character.

Perspective 1: Is the Welfare State Outdated?

Canada's national social programs are one of the greatest achievements of our history. Social programs have helped to build the sense of community and reciprocity which govern how people in Canada relate to each other. Canada's tradition of shared responsibility since World War II has nurtured a sense of who we are and how we define ourselves as a nation.

Far from being outdated, Canada's welfare state is widely judged to significantly provide for the well-being of immigrants, the elderly, the unemployed and the poor, create liveable cities and mitigate regional differences. There remain, however, areas for further development, such as child poverty, inadequate education, and growing inequities in the labour market.

The Canada Health Act expresses the principles underlying many national social programs: universality, accessability, and portability. The Canada Assistance Plan speaks to issues of adequacy for all persons in need, and the prevention and removal of the causes of poverty. It is due to the enforcement of such principles that Canadian citizens have one of the highest standards of living in the world, a legacy to be proud of and to preserve. As the evidence shows:

* Canada recently topped the list of desirable countries in which to live in terms of indicators such as health status and education, according to a recent United Nations report. (UNDP, Human Development Report 1994).

* Canada accepts more newcomers – relative to our size – than any other Western country. That we can do this in conditions of relative harmony, reducing tensions and disparities between ethnic and racial groups, is a testimony to our immigration and integration policies and to the fabric of our civic life.

* Since World War II, Canada has reduced social inequalities and national disparities through regional equalization payments, universal health care, social insurances, an inclusive system of public education, and pay and employment equity.

* Our social security system has provided basic citizens' rights across the breadth of this country. Regardless of where they live, all Canadians have access to good public schools and hospitals. Similarly, effective income maintenance programs have helped to provide economic security and human dignity for all people whether they live in a small or large, urban or rural community.

* Social programs have meant that our large cities are liveable because, unlike the U.S., we have not filled our cities with economically desperate people. Fiscal structures and legislation such as the Canada Assistance Plan (CAP), Established Programs Financing (EPF) and equalization payments, mean that roughly equivalent basic services must be provided everywhere. Therefore movement from regional to urban centres is more likely to represent expectations of achievement and opportunity. These are migrations of hope, not despair.

The assertions that Canada's social security system has broken down or that social programs no longer work are not born out by fact. On the contrary, evidence repeatedly shows that insufficient and poorly-paid jobs are leading to increased poverty and disenfranchisement, and that the only thing that has kept the poorest classes from a free-fall into destitution has been the safety net. (Social Infopac, Vol.12, No.1, 1993) The last ten years has tested the social security system; and in return for passing the test, it is now under attack. Simply put, a badly functioning economy is placing undue burden on social programs, not the other way around.

The Social Security Reform provides the federal government with the opportunity to build on Canada's legacy of achievement by recreating public policy in ways that viably address current economic and social realities. Unfortunately, this does not appear to be the direction the government is choosing to take. Instead, the reform process appears to be driven by the goal of cutting costs.

Public finances are at the heart of the struggle to redefine the quality and scope of the Canadian welfare state. Ironically, the arena of debate about public finances has been largely closed to the public. In the formulation of budgets and fiscal plans, the Finance Department relies on only one dominant perspective – the way to good nationhood is through the market. Looking at public finances through the lens of the marketplace has led us to prescribe balanced budgets through cutting costs. These costs are virtually equated with social spending.

Because so few alternative perspectives are sought and developed, this approach goes largely unchallenged in public discourse. What emerges is an apparent consensus, reaffirming that the fiscal crisis leaves us with no alternatives.

But the problem with the dominant perspective is that the policy changes it prescribes threatens to destroy the nation for the sake of strengthening the market. The decisions flowing from the federal government's fiscal plan and report for social security reform are pivotal. These will not be incidental reforms, simply geared to balancing national ledgers. Their impact will chart a radical course of change for that which is distinctive about Canadian life.

We believe that national options do exist to address the fiscal, economic and social crises of the 1990s and that the time has never been more urgent to put all viable options on the table.

Perspective 2: Two Decades of Distortion on the Fiscal Crisis

Canada's fiscal crisis is not the result of an unaffordable system of social programs. Canada has neither over-provided nor over-spent on social programs. Rather, Canada has *under-collected* relative both to the capacity of its citizens and corporations to contribute to the social security of Canadians and compared to other industrialized countries.

Source of the Fiscal Crisis:

Canada has had a primary expenditures surplus (all federal expenditures except interest paid on the debt) since the 1986-87 fiscal year. Indeed, primary expenditures have been declining every year since 1984, with the exception of the last few brutal years of recession. (Table 1) It is striking that, even under these economic conditions, primary expenditures were lower in 1992 than in 1975. Clearly, government spending is not out of control.

The fiscal crisis originated in undercollection of revenues in the 1970s and was exacerbated by rising debt charges due to the unprecedented interest rates of the 1980s. It did **not** arise from rampant spending on social security, which has remained relatively constant since the mid 1970s, with the exception of the recession periods of the early 1980s and the early 1990s. All other functions of the federal government have fallen dramatically in relation to the size of the economy, with the exception of debt service charges. (Appendix A)

Rising debt charges on Canada's accumulated debt consume a growing proportion of our public resources. The federal government now spends $41 billion annually – nearly 25 per cent of all federal expenditures or 6 per cent of our GDP – to service our debt. (Appendix B).

The False Dilemma: Don't Want Cuts but Can't Pay

For two decades we have been bombarded with the notion that we pay too much tax. What does the evidence show?

From 1976 to 1985, a majority of advantaged and middle-class Canadians, as well as Canadian corporations, enjoyed a **tax holiday** which resulted in a serious decline in public revenue. This was the initial factor contributing to Canada's current fiscal crisis. For the average Canadian these tax breaks took the form of full indexation in the personal income tax system and the substantial growth of tax shelters, such as RRSPs. Canada was the only G-7 country which experienced such a decline in public revenues. (Table 2)

The problem of a generalized tax holiday was compounded after 1987 when, in addressing revenue problems, the previous government broadened the tax base at the bottom and reduced the rates at the top, resulting in profound inequities in the tax system. These obvious changes have significantly reduced people's will to pay, especially in the light of continued reduction of publicly provided services and benefits.

Corporate contributions have declined most precipitously among all sources of federal tax revenue in the last twenty years. They accounted for only 7 per cent of federal revenues in 1992, down from 17 per cent in 1975. (They represented 25% of all federal revenue in 1955.) In relation to GDP, federal and provincial corporate contributions to public provision in Canada, both in taxes and social security payments, are lower than those in the U.S. and are the lowest of all G–7 countries, including Japan. (Appendix C.) Apparently, Canadian corporations have some latitude to increase their contribution with no threat to their existing competitive position.

In 1990, former Finance Minister Michael Wilson accurately observed that Canada was "among the world's most lightly taxed industrial countries". (The Globe and Mail, March 29, 1990) This fact still holds, despite the current protestations to the contrary by the Finance Department. Recently, Canada's deputy finance minister was quoted as saying that "the tax burden on individual Canadians and corporations is higher than in any other major industrial power except France". (Toronto Star, March 10, 1994) The evidence does not support this assertion. (Appendices C, D and E)

In fact, average Canadians pay less than average Americans for a significantly better society. Relative to the U.S., average Canadians enjoy access to a universal health care system, an inclusive and well–funded system of public education, and higher levels of support for seniors, the unemployed and the poor. The cost? Contributions of average Canadians to total government revenue are above those in the U.S. before social security contributions are taken into account. When social security contributions are included, average Americans pay more than average Canadians. (See Appendix D).

How should we pay for the debt? Cutting social programs to reduce the deficit makes no sense. The crisis of this period is not that we cannot afford to pay for social programs, but that we cannot afford to have an economy that does not work. The objective of reviewing social programs and public finances at this time should be to find fair and logical ways of paying for a system that works.

Perspective 3: National Options Exist to Enhance Social Security and Address the Deficit

For the past decade federal politicians have been telling us that there are no alternatives to cutting social entitlements. Canada does have national options for addressing the fiscal deficit which do not require us to dismantle the welfare state and erode the foundations of Canadian nationhood. Canadians should expect their federal government to exercise these options and play a key leadership role both domestically and internationally.

1. Focus on getting people back to work.

The only sustainable mechanism to reduce the deficit and restore financial health to the public and private spheres of society is full employment. A number of possibilities exist to create both more jobs and better jobs. First, we live in an era of paradox, where an unemployment crisis co-exists with more and more people working extremely long hours. Establishments which regularly rely on long hours of work – through paid overtime in examples such as heavy manufacturing and through unpaid overtime in examples such as managerial and professional salaried employees – should be required to **reduce and redistribute working time** so as to create new job openings.

Second, essential public services – such as child care, the development of preventive and corrective environmental technologies, supporting community-based health care, and building the training/upgrading infrastructure – should be prime sites of **public investment**, which in turn would generate needed and decently paid work.

Finally, in their capacity as corporate citizens, **more private sector job creation should be expected during a recovery**. This is only likely to occur, however, if: 1) **more of our savings are returned from offshore,** so they are made available for productive investment here; and 2) **more domestic consumption is supplied through domestic production**, rather than imports. These conditions can be met, respectively, by 1) returning foreign investment thresholds for pension/retirement plans to the 1989 levels (10%, instead of the current 20%), re-routing about $25 billion back each year for investment in Canada; and 2) identifying key sectors of the economy as vital to the national interest (as has been the case for the defence industry) and setting domestic production targets in these sectors (e.g. heavy machinery related to resource-extraction, technology associated with hydroelectricity, pharmaceuticals, etc.).

2. Review the mechanisms for paying the debt.

Canadian taxpayers spend 25 cents of every tax dollar to service the $41 billion in federal debt charges. An increasing proportion of that money (8.6% in 1983 to 23.6% in 1992) simply leaves the country in the form of interest to foreigners who hold our debt. Reviewing these expenditures is at least as important as reviewing expenditures on social programs. A variety of mechanisms could be weighed, from renegotiating the yields from bonds, to introducing interest rate controls, to relying more heavily on long term, strictly domestic instruments such as Canada Savings

Bonds (which can only be held by residents and have historically been the prime mechanism for financing Canadian debt). Since the financial community has long been alerting us to the dangers of debt "crisis", they should be required to finance part of it. Canadian banks and other large bond–holders could be required to take marginally lower returns as part of the belt–tightening exercise that the government has required of the unemployed and working poor for the past three years.

3. Re–regulate capital internationally through a Tobin tax.

The issues raised by increasingly mobile capital cannot be addressed through national strategies alone. Every day almost $1 trillion is exchanged in financial paper across national borders, approximately 40 times the value of international trade in goods and services. Canada could assume a leadership role in the international community by calling for the introduction of a one per cent transaction tax to be imposed on all currency trading in order to discourage short–term speculation, reduce exchange rate volatility and generate revenue for governments. First introduced by Nobel prize–winning economist James Tobin from Yale University in the 1970s, this idea is gaining popularity as the scale of international monetary transactions threatens to destabilize real economic processes of production, consumption and distribution.

4. Generate tax reforms that address both equity and adequacy concerns.

Many studies show that the federal deficit starts in the mid 1970s due to an undercollection of tax revenues, not overspending. Is there room for higher taxation? Who should bear these increases? These questions raise issues of both equity (who should contribute and how much?) and adequacy (what amounts are required for what levels of benefits and for whom?).

A comprehensive review of all forms of taxation and tax expenditures should be immediately undertaken. Tax expenditures such as retirement savings exemptions, protected family trusts and business corporate tax exemptions are perhaps more of a drain on public finances at a time of deficit crisis than social spending. In these cases, significant public revenues are "spent" on those who least need public support. As one example, the startlingly generous RRSP contribution limits could be reviewed as a possible source for financing the debt. (The current ceiling for RRSP contributions is $12,500, a limit wildly beyond the $2,567 claimed on average by 4 million Canadians in 1990, representing only 22% of tax filers, and causing the federal government to forfeit about $4 billion in revenues. A further $10 billion was forfeited through registered pension plans. The decision about how much of that could be retrieved is political, not economic.)

Tax deferrals and exemptions should also be reviewed. For example, the amount of federal taxes deferred by corporations due to fast write-offs for capital investment totalled about $3 billion in 1972. By the early 1990s, corporations had deferred almost $40 billion in federal taxes – roughly equivalent to the nation's debt servicing charges. If this is a fiscal crisis, it is reasonable to expect a review and reduction of such tax holidays.

The personal income tax system should also be reviewed regarding the rates of taxation, the numbers of tax brackets and their thresholds, noting that, between 1987 and 1989 the number of tax brackets fell from 10 to 3, with the top marginal rate of tax dropping from 36% to 29% while the bottom was boosted from about 7% to 17%. Alternative sources such as inheritance taxes or altering regulations regarding family trusts and/or capital gains exemptions should be examined. The construction of consumption taxes regarding the base, the rate, and harmonization with provincial taxes needs to be reassessed. So-called "payroll taxes" such as UI and CPP/QPP should be redesigned, with an eye to progressivity and sustainability. Finally, the possible disintegration of fiscal federalism as we know it (in particular the CAP and EPF structures) should lead to open discussion about reorganizing these public finances, for example through the development of a social investment fund.

Perspective 4: Preserving the Bonds of Nationhood Means Paying for Canada's Social Programs

The options have become clear: either we continue to dismantle national programs, both social and cultural, or we commit ourselves to paying for them. In so doing, we either make a commitment to democratic development – evidenced by people's growing capacity to participate and contribute – or we allow a drift to the polarization of American society, a society increasingly marked by marginalization, exclusion and desperation.

Redesigning the welfare state means improving existing programs and making new investments. At minimum, it means preserving the <u>level of provision</u> and the <u>principles</u> underlying provision – equity, inclusion, social cohesion. It does not mean having to protect every social program in its present form.

According to the federal government, asked what they want, Canadians overwhelmingly (78%) state that our social programs are essential. But this endorsement is contrasted by an edginess that calls into question the financial support of these programs every time their reform or review is mentioned.

The real "tough" choices facing Canadians arise from the fact that the linkage is rarely made between collection and provision. Too often the "how much tax" question gets played out in complete separation from what we are paying for.

Do Canadians have the capacity to pay for what they want? An entire culture is being cultivated in this country, convincing citizens that they pay too much in taxes. The legitimate questions underlying the reluctance to pay more are: "What am I paying for?" and "What is the other guy paying?" These concerns arise from the experience of taxes visibly increasing for most Canadians in recent years, while they lose benefits, services, supports and entitlements.

At the same time there has been an equally obvious growth in tax avoidance of wealthy Canadians and large corporations, who in some cases default on their own debts. Despite this performance, these are the same interest groups who seriously demand cutbacks from the unemployed and people on welfare. These everyday occurrences erode a sense of civic connectedness, the notion that we are all in this together.

Every year since the 1986–87 fiscal year, federal revenues have covered primary costs (all federal expenditures excluding the interest paid on the debt). Debt charges – paid to the private sector – have increasingly "crowded out" public investment and provision since then.

It is not necessary to borrow more money to undertake the public investments which must be made. A serious alternative to deficit management has been articulated in the previous section. In addition, we believe an important avenue to social and fiscal responsibility in public expenditures can be through self-financed designated funds.

Since the February 1994 budget it appears that the existing structure of fiscal federalism – financing structures supporting CAP and EPF, but also UI – is in demise. We raise the possibility of earmarked or designated funds, in combination with the preceding national options around the debt, as a means of sustaining national programs with national standards that respect the principles these programs were designed to support. Notably, the designated fund option (called "hypothecated" funds) has become a serious part of the public policy debate in Britain (The Manchester Guardian, August 18, 1994; The Observer, August 21, 1994).

These mechanisms are not programs but an integrated strategy for maintaining broadly supported national programs. They suggest more sustainable financing mechanisms for emergent social needs, while creating new employment in areas where there is a demonstrated need for further public investment. These include: child care, lifelong learning, community-based health care, and environment technologies (both corrective and preventive).

Our experience with contributions for UI, CPP, Workers' Compensation and (provincially) health care, show us that Canadians are willing to pay directly for services they understand that they can or will need at some point in their lives. In this light, we propose that the federal government immediately consider the creation of designated funds requiring corporate and citizens' contributions in the following three areas:

1. **A National Labour Market Investment Fund**, financed by employer and employee contributions, but also with an increased contribution from general revenues. This would provide a self-sustaining joint federal/provincial fund for learning, training and community employment programs for all who seek such upgrading, regardless of whether they are high-school dropouts, unemployed, on welfare, retooling their skills or currently employed. The employer contribution could be based on a grant/levy system, to finance on-the-job training, for which the employer gets the benefit. The employee contribution could be a pro-rated premium. General revenues would finance general upgrading programs with high portability, such as literacy and numeracy, as well as a portion of apprenticeship programs. This fund would not provide income support for the unemployed, nor provide wage support for employed workers engaged in training.

2. **A National Social Investment Fund for Families and Children**, which would use new corporate and citizens' contributions and re-direct some existing federal revenue to pay for an enhanced social security system for families with children including: a progressive children's benefit; a comprehensive child care system (including maternal/parental income support); a child support assurance system; and a national youth endowment program.

3. **A National Health Investment Fund**, financed by corporate and citizens' contributions, some of which would be a redirection of existing taxes. Canada, unlike most industrialized nations, has no national levy on health care. It would be possible to use such a fund to expand health services to cover dental and vision care, as well as drug expenditures for all citizens. Such an expansion of the system would remove considerable disincentives in the welfare to work transition, and relieve the privatized burden from a growing contingent workforce who have no coverage for basic benefits. Also, these benefits are expensive to finance in the private sector and are often invoked as a barrier to new hiring (in the form of a major fixed cost). Since pooling the risk across the entire population reduces costs (as evidenced by our Medicare system), it could be possible to create a level playing field among employers and reduce unit labour costs for many.

It is important to note that the sustainability of existing funds, such as our own Canada Pension Plan, depends on continuing political will to make sure that the contribution base is broad enough for the necessary coverage. This has been the European experience with public pension programs in contrast to our tendency to allow leakage of public revenue through tax benefits for private retirement plans.

This leaves two issues: income support for training; and income support for those who find themselves de-linked from the labour market.

It is possible to use UI as a more "active" system of income support for those who are training if: 1) existing "Developmental Uses" funds were re-allocated strictly to income support for the unemployed, rather than for direct training costs and wage supplementation; and 2) the UI system were re-designed to be more progressive, i.e. removing the ceilings, which would infuse the fund with more revenue, at least in the short term. (In the medium to long term the fund, being self-financing, would reduce the premium rates as premiums are set at levels that attempt to eliminate surplus or deficit from the fund over a three year horizon.)

The more difficult category for continued income support, which currently exists under the endangered CAP system, is for the non-photogenic poor: single employables. Though this system of investment funds relieves pressure from CAP, the need will still exist to provide, in a consistent manner, support for those unable to find sustaining work. If CAP is undone, its demise will pose a critical test of political and public will as to how we deal with those among us who tumble into this twilight world.

The crux of the issue remains this: It is not the fault of social policy that there is poverty and unemployment. What is proposed here is a fully integrated system of fiscally sustainable mechanisms. In and of themselves, these proposed investment funds do not eradicate the unemployment problem; but they do create a more integrated approach for dealing with the problem.

CONCLUSIONS

Opening the Doors on Public Finance

Public finances are at the heart of the struggle to redefine the quality and scope of the Canadian welfare state. Ironically, the arena of debate about public finances has been largely closed to the public. In the formulation of budgets and fiscal plans, the Finance Department relies on only one dominant perspective – the way to good nationhood is through the market. Looking at public finances through the lens of the marketplace has led us to prescribe balanced budgets through cutting costs. These costs are virtually equated with social spending.

What is missing in the spending cuts "debate" is the connection between revenue and security, between collection and provision. The capacity to finance social needs exists when people know what they are paying for, and when increased contributions result in enhanced – not decreased – supports and services.

National Options Do Exist

Because so few alternative perspectives are sought and developed, the imperative to cut spending goes largely unchallenged in public discourse. What emerges is an apparent consensus, reaffirming that the fiscal crisis leaves us with no alternatives.

Other options do exist, as evidenced by the Liberals' pre–election campaign, which stressed that the deficit flows from not enough people working. Equally valid are approaches to refinance the debt, redesign taxes, and regulate capital (in partnership with other nations). If the crisis is as deep as is continuously asserted, there is a certain urgency to put all viable options on the table.

Our nation is at a crossroads. If we do not address the lack of sustainable employment opportunities in this country, we continue to erode public will to support one another. If we do not pay for the programs we value, we dismantle them – as we are witnessing.

Public Leadership

The social security and fiscal reforms we are about to engage in are not just about programmatic changes. **They are about redefining nationhood.** Current trends reduce the role of government and charge markets with the role of creating wealth <u>and</u> social cohesion. Slow economic growth only accentuates the degree to which these goals conflict. This raises the stakes for a renewed commitment to public responsibility, just at a time when it appears to be on the wane.

It is time to restore a sense of trust in public institutions and government. National governments should be expected to set limits on the culture of "passive consumption", demanding that the marketplace must provide a living as well as a lifestyle. Canada must propose and take up the challenge of governing as if more than the economy matters, both at home and on the global stage. Designated funds are but one avenue of restoring a sense of trust in government and accountability to the public. We require political and civic leadership in opening serious options for debate at this critical juncture in our history.